# Weekly Review

WEALTH





– Issue – 13 Jan. 2016


***The latest ATO data shows many SMSF trustees are very skewed towards cash over other asset classes, and to Australian shares over international equities.***

BY JOHN CONROY • EUREKA REPORT • 12 JANUARY 2016

## SMSFs in a high-risk cash gamble

Many Australian self-managed super fund (SMSF) trustees are wedding themselves to mediocre investment returns by having a high percentage of their funds in cash and term deposits.

***Key Point***

- ***Cash returned just 2.1 per cent in 2016 compared to the 11.65 per cent from Australian shares. Those keeping their funds locked in bank accounts on the sidelines are missing out on much higher returns.***

New data from the Australian Tax Office shows that SMSFs collectively hold more than $157 billion in cash, equal to 25 per cent of the $635bn in total assets held by DIY fund trustees at September 30, 2016.

But in being ultra-conservative, foregoing the much higher investment returns generated by other asset classes, those with large cash holdings are effectively jeopardising the longevity of their retirement savings.

With record low interest rates, the median return from cash in 2016 was a paltry 2.1 per cent compared with a much higher 11.65 per cent return from the Australian share market in the year to December 31. In other words, $100,000 invested into cash would have returned just $2100 over the last year compared to $11,650 from the same amount invested in the share market.

While the proportion of SMSF money in cash and term deposits has fallen gradually – down from 32 per cent to 25 per cent in the four years to the end of the third quarter last year, which is the most recent data available from the ATO – the discrepancy in returns of that period is stark.

About 10 per cent of SMSFs are entirely in cash and term deposits, while a quarter of funds have more than 50 per cent of total holdings in the asset class.

The ATO data shows those heavy in cash and term deposits are likely to be smaller funds, with diversification expanding as the value of SMSFs increases, most noticeably for funds beyond the $200,000 mark.

Of course, SMSF trustees should have a small percentage of funds allocated to cash, especially those in retirement phase needing liquid funds to make regular pension payments.

### SMSFs remain unguided

Analysts had expected a bigger wind-down in cash holdings since the latest round of monetary easing began in 2012, with the official cash rate dropping from more than 4 per cent to its current 1.5 per cent level.

Jason Dunn of Anne Street Partners Financial Services said the ATO data showed many SMSFs remain "totally unguided" in their investment decisions and have a "huge amount" of their assets invested in cash.

"While cash serves a key purpose in a SMSF, it's important to strike the right balance of defensive and growth assets dependent on your situation and stage in life. The reality is that you need to be prepared to provide for your own


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retirement. Australian women now live to an average age of 84.5 and for men 80.4, ABS statistics show."

According to data group Canstar, the best an SMSF can get for a term deposit presently is 3.2 per cent invested for five years, with interest paid annually. As such the invested cash balance only benefits from compound interest every 12 months.

By contrast, the All Ordinaries Accumulation Index (which includes dividends in determining total annual returns) has averaged about 10 per cent annually for the past four years.

The key for investors currently heavily invested in cash and term deposits is to weigh up the desire for certainty over the need for higher investment growth and income. Those with large cash holdings are often achieving returns that barely match inflation, meaning their funds will be severely eroded over time and are unlikely to last through retirement.

## Home bias still unhealthily strong

Meanwhile, the updated ATO figures show SMSF trustees also remain very light on international shares compared to their ownership in domestic companies, although those weightings have thus far not been costing them money.

In terms of shares, 31 per cent of SMSF holdings were in listed Australian shares at the end of the September quarter, while listed international shares accounted for a paltry 0.6 per cent of all holdings (the figures do not take into account domestic and international shares held in managed funds.)

The sharp equity markets divergence is put into context when considering the Australian share market represents only about 2 per cent of the value of global markets.

Brokers Morgans last week íssued a warning on the issue.

"Home bias is an obvious concern, with direct (SMSF) equities investments 98 per cent skewed towards domestic stocks. We think this lack of diversification within the Australian equity market poses a risk to domestic investors," the broker wrote in a note.

Morgans said the Australian economy was "facing challenging headwinds that have the potential to drag on growth over the medium term".

### Table 1: SMSF holdings, changes over 12 months to September 30, 2016

| SMSF ASSET CLASS | VALUE IN $M (PORTION OF OVERALL HOLDINGS) | PERCENTAGE CHANGE (%) |
|---|---|---|
| LISTED SHARES | 192,404 (30.2%) | +13.3 |
| CASH AND TERM DEPOSITS | 157,390 (24.6%) | +2.8 |
| NON-RESIDENTIAL REAL PROP | 72,092 (11.3%) | +7.5 |
| UNLISTED TRUSTS | 61,703 (9.7%) | +10.4 |
| OTHER MANAGED INVESTMENTS | 32,244 (5.1%) | +6.9 |
| LISTED TRUSTS | 27,495 (4.3%) | +10.4 |
| RESIDENTIAL REAL PROP | 25,714 (4%) | +7.5 |
| LIMITED RECOURSE BORROWING ARRANGEMENTS | 23,421 (3.7%) | +7.5 |
| OTHER ASSETS | 16,826 (2.6%) | +0.6 |
| DEBT SECURITIES | 8135 (1.3%) | +2.8 |
| UNLISTED SHARES | 6322 (1%) | +0.6 |
| LOANS | 3943 (0.6%) | +0.6 |
| OVERSEAS SHARES | 3655 (0.6%) | +13.3 |
| O'S ASSETS, OTHER | 2847 (0.5%) | +13.3 |
| O'S MANAGED INVESTMENTS | 736 (0.1%) | +13.2 |
| COLLECTABLES/PERSONAL USE | 401 (0.1%) | +0.7 |
| O'S RES REAL PROP | 256 (0.04%) | +13.3 |
| O'S NON-RES REAL PROP | 256 (0.04%) | +12.4 |
| INSURANCE | 155 (0.02%) | 0 |

**Source: Australian Taxation Office**

> **With record low interest rates, the median return from cash in 2016 was a paltry 2.1 per cent compared with a much higher 11.65 per cent return from the Australian share market.**

"Current profit growth in the domestic market is forecast by Bloomberg at a modest 7 per cent in FY17 and 5 per cent in FY18 driven by a turnaround in resources. On a relative basis Australia looks to be a laggard across global markets," Morgans said.

However, interest is growing in the international shares space. The September 2016 figure of 0.60 per cent (or just $3.66 billion) is an improvement on the proportion of holdings from the four years prior – 0.37 per cent (or $1.59bn).

And over the 12 months to September 30, 2016, the value of holdings in listed international equities rose 13.3 per cent against an increase in overall net SMSF holdings of 8 per cent. (The value of Australian shares also rose by that 13.3 per cent, however).

November and December saw strong positive momentum for **InvestSmart's International Equities Portfolio**.

Europe was the best performing market for December, rising 7.4 per cent, while the US market gained 3.9 per cent, and Japan and emerging markets returned 3 per cent and 2.9 per cent respectively.

Getting allocations right – cash versus growth assets, like equities, and international equities versus Australian equities – will be increasingly important in 2017.

While SMSF trustees have been losing with cash compared to benchmark equity indexes, past returns are no guarantee of future performance.

Meanwhile, diversification between Australian shares and international holdings is as important as ever given our market's strong weighting towards the major banks and mining stocks. Good diversification is vital.

*Is it worth taking out a loan to tip money into super ahead of June 30? It's a very different equation in 2017 to 2007.*

BY BRUCE BRAMMALL • EUREKA REPORT • 11 JANUARY 2016

# Does borrowing for super make sense?

Getting money into super ahead of the June 30 change of rules is going to take some planning.

From June 30, if you already have $1.6 million in super, you will not be able to put non-concessional contributions (NCCs) into your fund.

***Key Point***

- ***Those wanting to top up their non-concessional contributions before July 1 to take advantage of the higher limits before they're cut may want to consider borrowing funds at low interest rates. But there's a lot to consider. For some, the strategy may make sense but others need to tread carefully.***

With one last chance to get up to $540,000 into super, will it be worth it to borrow money to get it into super?

The last time this was an option being seriously contemplated was back in the lead-up to June 30, 2007. At that time, ahead of Peter Costello's big changes, we had a one-off chance to tip in $1 million in NCCs. Back in 2007, many found it tempting to borrow.

But the answer to the borrowing question in 2007, compared with 2017, was very different.

### Low interest rates

Firstly, this is because of interest rates. Back in early (and, importantly, pre-GFC) 2007, interest rates were around 8 per cent. Now, they're circa 4 per cent.

This is important, because if you borrow to put money into superannuation the interest on the borrowings is not tax-deductible. (For the interest to be a tax deduction, the funds need to be used to generate assessable income in the name of the borrower. And your SMSF is a separate entity, so there's no tax deduction.)

Back in 2007, my advice to clients was "no, don't do it". My reasoning was that it was unlikely, on balance, to be a good idea. The required earnings rate needed to beat the prevailing interest rate (even ignoring super tax) outside of super was too high. And, long term, that was a big risk (even given the bull run that equities were experiencing back then).

However, with the cost of capital having halved over that 10-year period, the equation looks quite a bit different.

The break-even point – with a bunch of variables ignored – is significantly lower. No guarantees, and you're still punting on markets rising. But the hurdle is, at least, lower.

### A different investment climate

Secondly, the investment atmosphere in 2017 is very different to 2007.

Back then, markets had been running white-hot for about four years. They were soon to go into freefall, but I'm not going to claim to have predicted that.

In the lead-in to 2017, there is not as much concern about overheated markets. Yes, we've had a post-Trump bounce. And preceding a bland FY16, there were three good financial years between FY13 and FY15. But we're not talking bull-run here.

(Footnote: Obviously, anyone who did put $1 million in their super funds in early 2007 and then invested it in share or property markets was feeling a deep pain 12-18 months later.)

### Super is changing forever

Third, the regulatory environment is different. The largesse of the super system is being wound back.

Costello's 2007 changes were the zenith of superannuation in Australia. Things will never be better than they were then. And it's been all downhill from there. It doesn't seem to be a tide that will turn.

In 2007, the "$1 million opportunity" was a gift horse to the wealthy. It will be the last time, in our lifetimes, such a gift will be offered.

But ... there will be individuals out there who want to get that money into super and who don't have it as liquid assets at the moment. It may, in some cases, make sense to borrow money to tip it into super.

If you have reached preservation age, then knowing that you can draw on your super to repay the debt is some consolation and a potential plus for doing so.

> **If you borrow to put money into superannuation the interest on the borrowings is not tax-deductible.**

And the closer to preservation age you are, the less risk the strategy obviously holds.

Being able to invest in a low- or no-tax environment, with a cost-of-funds of 4 per cent, will be something worth considering for some.

However, don't do it without properly running the numbers for your situation or getting a financial adviser to help you to do so.

For some who already have significant assets inside and outside super, it might be worthwhile stuffing more money into super. Even if you have more than $1.6m in super/pension, is it better to be taxed at a maximum of 15 per cent inside the super system than to have that money sitting outside super, where it will be taxed at up to 49 per cent?

The appeal of getting $540,000 into super might make some real sense, if the debt can be later repaid, easily.

If you're a couple? Well, you might be able to get $1.08m ($540,000 x 2) and have double the benefit.

## Last shot

If you have more than $1.6m in super on July 1, 2017, you won't be able to put further NCCs into super. Not at the current rate of $180,000 a year (or $540k pull forward), nor at the post July 1 level of $100,000 (or $300k using pull forward).

But you can load up prior to then, though the money might have to, eventually, stay in super's taxable regime.

Let's say that you currently have $3m in super/pension and you're 64 (or younger). And you have the means to put in another $540k this year (either via borrowings, or cash).

The answer, if you hold cash, is likely to be a no-brainer. Yes. Depending on the quantum of your assets outside super, it's likely that even if all the contributed funds end up being pushed into accumulation/super phase, that the 15 per cent tax rate (or 10 per cent for capital gains) will be preferable to the level of tax likely to be paid on those funds outside of super.

If you can put it in, but with the source of funds being borrowings, then the answer could still be, yes.

If you do your sums and believe that, despite not getting a tax deduction on the funds for the borrowings, that getting the money into a low-tax environment to allow it to grow and compound is worth it … then speak to an adviser who can help you cement your plans.

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**The information contained in this column should be treated as general advice only. It has not taken anyone's specific circumstances into account. If you are considering a strategy such as those mentioned here, you are strongly advised to consult your adviser/s, as some of the strategies used in these columns are extremely complex and require high-level technical compliance.**

***Taking time to set a plan of attack for 2017 will be a great investment.***

BY CAROL TAWFIK • EUREKA REPORT • 10 JANUARY 2016

# A financial plan of attack for 2017

A demanding career, busy family life and all sorts of other potential commitments can certainly leave little time and attention span to stop and take stock of our overall financial health, let alone do something about it.

***Key Point***

- ***It can be difficult unwinding the compound effect of our financial decisions – and indecisions. But the key to success is taking action.***

Sometimes this lack of attention can have at its core a less than healthy relationship with money. Rather than it be something we approach with enthusiasm, it may have always been something subconsciously avoided for one reason or another.

A tendency to ignore something in the hope that it will go away or simply resolve itself (sometimes known as the "ostrich effect") can be something that plagues us all at one time or another.

When it comes to keeping our financial house in order, a range of things can be the source of our inaction, for example uncertainty around where to begin, not wanting to face up to potential bad news, lack of resources or, even, too much information. Unfortunately it can be very difficult to unwind the compounding effect of our financial decisions, or indeed indecisions. Heading into a brand new year is a great time to take stock and resolve to create a better relationship between money and you:

## Get excited about what can be achieved

From elite athletes to high achieving business people, successful individuals will attest to the benefit of creating a long-term vision and setting out a road map to incrementally move toward it.

All too often our thinking around our personal finances can carry some association with stress or a problem, which can lead to a head firmly in the sand. There is often no greater motivator than visually seeing what can be achieved when some discipline and consistency is applied.

A financial advisor can provide these tools or, alternatively, as a starting point get acquainted with some of the useful online calculators (**MoneySmart**) that produce helpful graphics. The significance of goal setting has been well documented so it all starts with first focusing on what you can achieve and what is most important to you.

## Information overload

Social media, email and various news sources all at our fingertips provide a constant stream of information, some of which can be quite conflicting. Information overload, a term coined by Professor Bertram Gross, is a real phenomenon which can leave one with an impaired ability to make a decision.

In his book ***The 4-Hour Body***, Tim Ferriss talks about Minimal Effective Dose (or MED) which refers to the point at which any more exertion would simply be ineffective or wasteful of resources that could be used elsewhere. The concept can certainly be applied quite broadly, including the way we consume information. When it comes to financial news, too much can certainly be counterproductive to effective decision making. It may be worth thinking about if and how this has affected you and taking a different view in 2017.

## Outsource

You are not expected to know it all. Getting all of the pieces of your financial house in order is quite simply a complex task. Knowing where your time and capacity ends and tapping into the benefits of outsourcing can be substantial. As well as gaining access to expertise (in a range of areas that cover your financial life, from investments to estate planning), looking to professionals can mean lower stress, peace of mind, better outcomes and limiting the opportunity cost of doing nothing. Perhaps most importantly, it allows more time for you to focus on what is most important to you.

> **“It can be very difficult to unwind the compounding effect of our financial decisions, or indeed indecisions.**

### Lazy cash

With cash rates at record lows and unlikely to deliver remarkable returns in the near future, it may be time to reassess and ensure your funds are allocated appropriately.

Cash is likely to be an integral part of any well diversified portfolio, from savers to retirees alike. Beyond a reasonable cash reserve or allocation it may be worth exploring alternatives and ensuring that, within an acceptable level of risk to you, your investments are working hard for you.

### Do the hard stuff first

If it’s your job to eat a frog, it’s best to do it first thing in the morning. And if it’s your job to eat two frogs, it’s best to eat the biggest one first. Be it making an appointment to see your solicitor to make a will, talking to your payroll department to start some salary sacrifice to superannuation or dealing first with bad debt, resolving to tackle that one big thing that you have been procrastinating on first thing in 2017 can get great momentum going, setting a productive tone for the year ahead.

Improving our relationship with money doesn’t mean knowing it all, but sometimes it is simply recognising and addressing the potential source of our procrastination. The key to success is taking action. Once the holiday season’s hustle and bustle is over, taking time to set a plan of attack for 2017 will be a great investment.

*Carol Tawfik is a Certified Financial Planner and advisor with Affinity Private.*

***The retail and mining sectors are benefiting from some nice conditions, although a slowdown in residential construction is set to weigh on GDP – and maybe property prices.***

BY CALLAM PICKERING • EUREKA REPORT • 11 JANUARY 2016

# Economic scorecard shows good results

We may have started a new calendar year, but the economic debate remains firmly rooted in the final months of 2016.

Over the past week we have started to receive indicators for November, which provides some insight into whether the economy will avoid its first recession in a quarter century.

### *Key Point*

- ***Cafes and restaurant spending is up 6.6% over the past year and household goods 3.7%. A return to trade surplus is welcome but maybe atypical, while property builds are down for a sixth straight month.***

Australian policymakers and investors will be relieved to know that the recent data flow has been pretty good. Retail sales are growing at a solid pace, while Australia has a trade surplus for the first time since March 2014. Building approvals may have declined recently but this won't hit economic activity until well into 2017.

### Retail revival

Australia's retail sector struggled throughout most of last year but has staged a mini resurgence over the past few months. The data for November saw a consolidation of that trend, despite falling short of market expectations, and should be viewed as a positive by market participants.

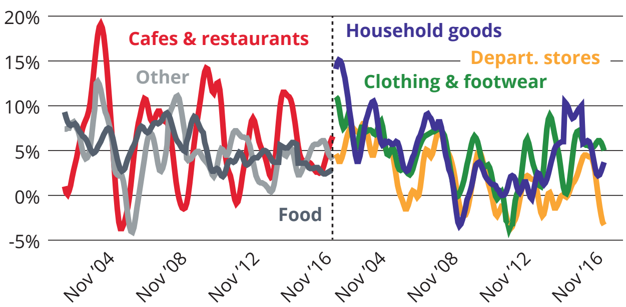
Retail spending rose by 0.2 per cent in November, following average growth of around 0.5 per cent in each of the past three months, to be 3.3 per cent higher over the year.

With household spending accounting for around 57 per cent of real GDP and the retail sector accounting for around 30 per cent of that, a healthy retail sector is paramount for a thriving economy.

Cafes and restaurants and household goods have been the two strongest industries for retail spending over the past six months. Spending at cafes and restaurants has increased by 6.6 per cent over the past year on a trend basis; spending on household goods is up 3.7 per cent over the same period (with almost all that growth occurring in the past six months).

The main source of risk for the household sector comes in the form of soft wage growth. This has constrained the retail sector in recent years and while there have been pockets of strength the sector has struggled to find genuine momentum.

**Chart 1: Australian retail spending by industry (year-ended percentage change; trend)**




Source: CP Economics, ABS

The recent pick-up in commodity prices, if sustained, could support the retail sector somewhat by boosting income growth. However, I anticipate that commodity prices will fall somewhat throughout 2017 so any boost should be short-lived.

### Property inflection point

Residential construction, accounting for around 3.8 per cent of real GDP, has been a source of strength for the Australian economy over the past few years. It has helped to offset some of the damage done by falling investment across the mining sector.

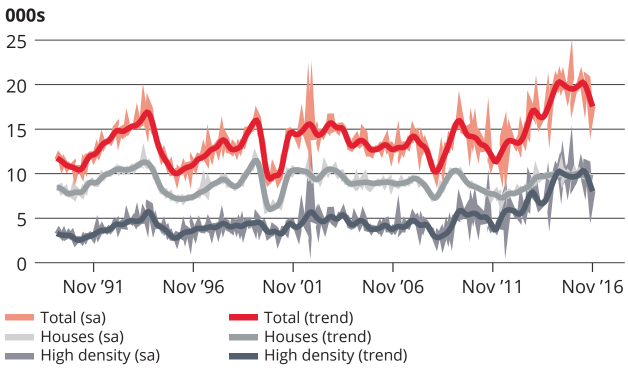
Building approvals are a leading indicator of residential construction. Released monthly, they are one of the most closely watched indicators of domestic activity and one of the few indicators that provides insight on future, rather than past, activity.

Building approvals fell by 2.9 per cent in November on a trend basis, the sixth consecutive monthly decline, to be 10 per cent lower over the past year. Approvals have now fallen by 13.4 per cent over the past six months and are expected to decline further as approvals return toward more sustainable levels.

> **"Australia's retail sector struggled throughout most of last year but has staged a mini resurgence over the past few months.**

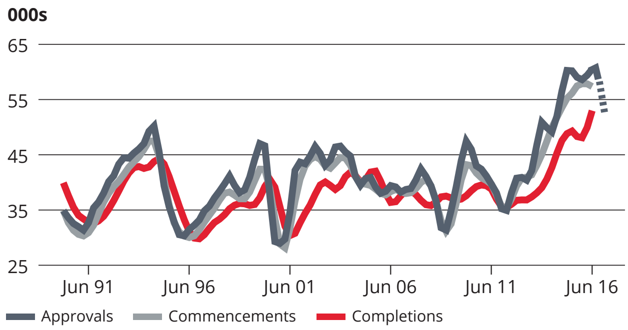
The recent weakness has been driven by a decline in apartment approvals, which suggests that the number of cranes that dot our city skylines will slowly begin to decline as projects are completed.

**Chart 2: Australian building approvals (no. of approvals; seasonally adjusted)**




Source: CP Economics, ABS

**Chart 3: Australian residential building activity (quarterly; trend)**




Source: CP Economics, ABS

Residential construction activity will remain at a high level throughout 2017 and 2018 in an absolute sense. But beginning this year it will begin to subtract from real GDP growth on a quarterly basis. Construction activity should decline over the remainder of the year, although we may see some growth during the first half.

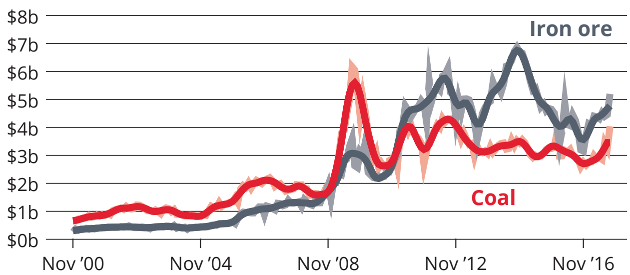
The relationship between approvals and completions is shown in the graph below. We can get a sense for how long it takes for an increase or decrease in approvals to effect construction and completions.

From an investors' perspective there is keen interest on what this all means for house prices and property investment. Although residential construction activity will begin to subtract from economic growth, we can see that the number of approvals and completions remains at an elevated level. High levels of new supply will put some downward pressure on house prices and rents, although this could be offset by other factors.

## International trade

We are seeing some welcome developments across the mining sector recently, with higher prices of iron ore and coal boosting income and profitability across the sector. In the process, Australia's trade balance has shifted into surplus for the first time since March 2014.

**Chart 4: Australian iron ore and coal exports (monthly; seasonally-adjusted)**




Source: CP Economics, ABS

The trade surplus sat at $1.24 billion in November, from a deficit of $1.12bn in October, on the back of higher commodity prices. The graph below shows the value of monthly iron ore and coal exports; both remain well below their peak but have improved significantly in recent months.

> **Building approvals are a leading indicator of residential construction. Released monthly, they are one of the most closely watched indicators of domestic activity.**

The key question for investors is one of sustainability. Sure commodity prices have increased but how long is that likely to last? There is always considerable uncertainty surrounding these markets but it appears likely that prices will moderate somewhat during 2017.

Prices have been boosted in large part due to temporary factors that have hit supply but the effect of this is already beginning to diminish. As this occurs we are once again left with excess supply, which was the main reason why commodity prices collapsed in the first place.

Meanwhile, capital outflows from emerging economies, including China, are likely to reduce demand for Australia's major commodities compared with expectations. Capital outflows equal weaker-than-anticipated investment, which is ultimately undesirable for commodity prices and Australian miners.

Since the return to surplus has been driven by higher prices it is unclear what this means for export volumes. It is quite possible that we see an increase in export income despite selling lower volumes, which is the opposite of what has occurred over the past few years.

If that eventuates we would have the odd situation where exports subtract from real GDP growth despite an improvement in mining income and profitability. This would be treated as a negative result by the financial media and yet there isn't a miner in Australia who wouldn't trade lower volumes in return for higher profitability.

***In the absence of error, the re-auditing of accounts just to gain a Centrelink or tax advantage is not an option. Meanwhile, those with pension accounts well over $1.6m need to get on their bikes.***

BY MAX NEWNHAM • EUREKA REPORT • 10 JANUARY 2016

# Tax with Max: Getting it right before July 1

***Q.*** *My husband is 65 and I am considerably younger. He has $1 million in pension phase in our SMSF, and I have $300,000 in accumulation phase. In the 2016 financial year he made a non-concessional contribution of $180,000 into his pension account. We wish to transfer funds from his pension account to my accumulation account so he can qualify for the Centrelink age pension.*

*Could we amend the 2016 tax return and have the accounts re-audited to have the $180,000 NCC shown as my contribution? Could we also for the current financial year have him withdraw $540,000 and have me make an NCC using the three-year bring forward rule?*

**A.** The first point I need to clarify is that your husband could not have made an $180,000 non-concessional contribution (NCC) directly into his pension account. Super contributions, whether they are concessional or non-concessional, must first be made to an accumulation account and then rolled into a pension account.

This means in your husband's situation the $180,000 NCC would have first gone into an accumulation account and then rolled into a pension account. This would have resulted in him having two pension accounts.

His other option would have been to make the NCC, commute his $820,000 in pension back into accumulation phase, and then commence a new pension account of $1 million.

For him to have made the NCC of $180,000 he must have passed the work test if the contribution was made after he turned 65. If he did not pass that work test, and there has in fact been an error made by the contribution being classed as his when he could not have made it, you could have an arguable case for the 2016 accounts being altered to show the contribution coming from you.

If your husband was entitled to make the NCC you could face problems in having the 2016 accounts changed and re-audited unless another mistake of fact has been made. You could not change the 2016 accounts just to gain a Centrelink or tax advantage.

To change the 2016 accounts you would need to have some form of documentation – such as a letter from you as the member stating that you made the $180,000 contribution and that it had been mistakenly allocated to your husband – that could be shown to the super fund's accountant and auditor.

There is n othing stopping your husband withdrawing $540,000 from his superannuation pension account, and then you making an NCC of $540,000 before June 30, 2017. As a result of the superannuation changes that commence on July 1 this year will be the last time that an NCC of $540,000 can be made.

The NCC limits from July 1, 2017 will be $100,000 a year, or up to $300,000 if a person qualifies for the bring-forward rule. When someone triggers the bring-forward rule in the 2017 financial year, but does not contribute the full $540,000, they will be limited to only making an NCC of $380,000.

This strategy of the $540,000 being withdrawn from your husband's pension account, and you making an NCC of the same amount, will only work if the assets counted by Centrelink excluding the value of your family home and your superannuation are worth less than $816,000.

***Q.*** *I have a number of questions relating to the new superannuation and pension rules that commence on July 1, 2017.*

- *If I contributed $100,000 to a super pension account now and take it out before June 30, 2017, is it still going to count as part of my transfer balance on June 30, 2017?*
- *Do lump sum withdrawals from a pension account in 2018 – for example, $100,000 from a $1.6 million superannuation pension balance – reduce my transfer balance and can I then top up to $1.6m at a later date? Does this apply to regular pension payments?*
- *Can I move part of my $1.6m in pension to an accumulation account in 2018 and then move it back to pension, or have I used 100 per cent of my transfer balance?*

> **Super contributions, whether they are concessional or non-concessional, must first be made to an accumulation account and then rolled into a pension account.**

- *If I have $1.6m in a pension account in 2018 can I still contribute to an accumulation account, provided I meet the non-concessional and concessional rules?*

**A.** Taking your questions in the order that you have asked them:

- If you make a non-concessional super contribution of $100,000 which is rolled into a pension account during the 2017 financial year, and that is either paid out as a lump sum pension payment or a lump sum commutation, your transfer balance at July 1, 2017 would not be affected. In other words, any activity during the 2017 year in superannuation accumulation and pension accounts only has an effect in determining what the balance of a person's accumulation and pension accounts are at the date the new rules apply, on July 1, 2017.
- If a $100,000 amount is withdrawn from a pension count as a lump sum pension payment this does not have an effect on reducing a member's transfer balance account. For the $100,000 withdrawal to affect the transfer balance account it must be done as a commutation payment. If it is done as a commutation you can top up your pension account back to the $1.6 million limit at a later date.
- To transfer a sum of money from a pension account into an accumulation account, this must be done as a commutation. In other words, a portion or the entire pension must be finished or commuted and then rolled back into accumulation phase. This is treated as a credit and the amount will decrease the transfer account balance.
- Under the new rules once a person has $1.6m in superannuation they are unable to make any further NCCs. They will still be able to make concessional contributions if the relevant rules are met. The only tax-free contributions, or NCCs, that the $1.6m limit does not apply to are those that can be made by qualifying small business owners under either the 15-year or the retirement capital gains tax (CGT) exemptions.

***Q.** My wife and I are aged 81 and 82 years. We have an SMSF with equal amounts of approximately $2 million each in pension accounts. Can we leave these funds in the SMSF and simply pay the 15 per cent tax on the surplus?*

**A.** You are the perfect example of a couple that must take action with regard to the amount you have in superannuation before June 30, 2017. This is because, if you both did nothing between now and the deadline, the excess over the new $1.6 million transfer limit will be greater than $100,000 each.

Where a member's superannuation pension balance exceeds the $1.6m limit by less than $100,000, and they correct the breach within six months, the excess will be disregarded and no penalties will be payable.

In addition, you will have access to the capital gains tax relief that effectively means any unrealised capital gains made on investments transferred back into an accumulation account will be protected, thus avoiding paying CGT of 15 per cent on the unrealised gain.

*Got a question for the Tax with Max column?*

*Email:* ***askmax@eurekareport.com.au***

***Our major miners' capital gains have 'recovery bounce' written all over them, with the next phase of the mining revival likely to be more about cash flows and dividends.***

BY TIM TREADGOLD • EUREKA REPORT • 12 JANUARY 2016

# Can mining repeat its resplendent 2016?

Higher commodity prices and lower operating costs made mining the top performer on the Australian stock market in 2016, but whether the sector has risen too far too fast is a question worrying investors, perhaps unnecessarily.

### *Key Point*

- ***The mining boom of 2016 is likely to slow in 2017 but the long-term trend is up.***

Some prices will fall after overshooting on the upside with the retreat of metallurgical (steel-making) coal from a peak of $US310 a tonne in November to latest sales at $US185 a perfect example of what to expect.

The trick with looking at met-coal is to see through the 40 per cent fall over the past two months and look at the $US74 price at this time last year. In other words, is met-coal really down 40 per cent, or up 150 per cent?

The answer is both because that's what happens when a commodity market adjusts to changes in underlying supply and demand, with yo-yo like moves part of the mechanism in seeking price equilibrium.

Unfortunately for investors in the mining (and oil) industries a point of commodity-price equilibrium is rarely achieved, meaning that choppy conditions are normal. The key to success is being able to see through the day-to-day moves in order to identify the long-term trends.

In the commodity sector the trend for 2017, and almost certainly for the next few years, is up. This is good news for Australia and can already be seen in the sudden improvement in the country's trade balance and the US2c rise in the exchange rate to around US74c.

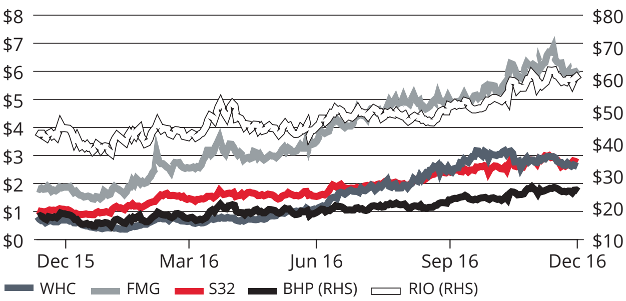
What's happened is that the price crash of 2014-15 has done its work in shaking out high-cost producers, leaving the way clear for low-cost producers to enjoy a period of rising demand as China continues to grow and the US gets ready for its own period of rebuilding.

The big winners in Australia from this period of rising demand and steady (if not falling) supply will be the usual suspects: the low-cost leaders in BHP Billiton, Rio Tinto, Fortescue Metals, Whitehaven Coal and South32.

Second-ranking miners such as OZ Minerals, Sandfire and Alumina will benefit from the better commodity-price climate, while gold stocks will rise and fall on global uncertainty, especially in the early days of the new US presidency.

However, it would be most unwise to imagine that BHP's share price will rise by another 88 per cent as it did in 2016 from a low of $14.06 (after a dividend cut) to a recent $26.42. Or for Rio Tinto to put on another 70 per cent ($36.53 to $62.71). And it would be foolish to expect another 700 per cent rise by Whitehaven (35c to $2.83) or another 300 per cent rise by Fortescue ($1.44 to $6.24).

**Chart 1: The only way was up – major miners' share prices in 2016**




Bloomberg, Eureka Report

Those capital gains have 'recovery bounce' written all over them, with the next phase of the mining revival more about cash flows and dividends.

There are several big themes to watch over the next six to 12 months which will influence the mining and oil industries, including:

- Cash flows being sharply higher than at any time in the past five years thanks to that combination of higher commodity prices and lower operating costs. By some measures, profit margins today are higher than they were in the boom year of 2011.

> **"Unfortunately for investors in the mining (and oil) industries a point of commodity-price equilibrium is rarely achieved, meaning that choppy conditions are normal.**

- The potential for a sharp rise in the value of the Australian dollar as trade conditions continue to improve.
- The reaction of mining company managements to this sudden positive turn of events, with critical decisions required in handling surplus cash.
- Retiring debt will be the priority for most miners, but shareholders will demand a share of the spoils in the form of higher dividends and/or share buy-backs.
- An increase in merger and acquisition (M&A) activity as management looks for ways to achieve easy growth, a trend which can produce as many losers as winners with the key to success in most periods of intensified M&A being 'buy the target and sell the bidder'.
- A revival in exploration, which will revitalise the small end of the mining sector, and;
- The return of conditions conducive for initial public offerings (IPOs) after several lean years.

Increased exploration expenditure, which will mean stronger news flow from the field, and a potential flush of IPOs will come later in the recovery cycle. The most immediate feature of the sector is likely to be the high-quality dilemma of what to do with rising cash flows.

Late last year the cash question was identified by analysts at UBS, an investment bank, as one of the big themes for 2017, with a snappy headline on an Australian resource sector research report perfectly capturing the issue: '2017 Outlook: Printing money'.

After noting that 2016 had not "panned out" as most investors might have expected, UBS said that 2017 was likely to see "improved free cash flows (FCF) and returns to shareholders".

"We expect the February reporting season to see healthy profits and improved FCF with some miners well positioned to surprise with increased returns, such as Rio Tinto and South32," UBS said.

A risk with the rising cash tide and improving balance sheets as debts are retired is that some mothballed mines could be restarted, though UBS believes that's a question for the second half of 2017.

Of the many issues for mining in 2017 (most of them positive), the big three are:

- China, and its appetite for resources;
- Trump, and his capacity to ignite a damaging global trade war, and;
- Currency values, and the point at which gold enters the investment equation given its dual role as a commodity and currency.

China, from an Australian mining company perspective, is critical. It was demand for basic raw materials – such as iron ore and coal – which drove the 2016 commodity-price recovery that led directly to the surprise improvement in Australia's terms of trade.

The November flip from a trade deficit to a trade surplus was one of the biggest events of 2016, with increased volumes mingling with higher prices to produce the first monthly surplus since March 2014.

Reaction on the currency market, so far, has been muted. But there is the potential for the recent US2c rise to become a lot more because three years ago the exchange rate was above US90c. A return to that level, or higher, would dampen mining company profits on conversion to Australian dollars.

Trump, the wild card in any attempt to forecast what might happen this year, appears unlikely to deliberately cause a trade war. It is more likely to occur accidentally, though the result would be the same; reduced demand for Australian resource exports and lower prices.

> **“ A risk with the rising cash tide and improving balance sheets as debts are retired is that some mothballed mines could be restarted, though UBS believes that’s a question for the second half of 2017.**

For the next six weeks investors will be watching the full and half-year reports of the big miners, starting on Monday when Rio Tinto releases its December quarter production report, a document which will contain the numbers to allow analysts to finalise their estimates of the company’s full-year profit (due for release on February 8).

BHP joins the reporting game on January 25 with its December quarter production report, leading up to its half-year profit (and dividend) statement on February 21.

Higher dividends are what shareholders want from the big miners, and their wish might be granted, though management will be cautious because of concerns about the global economy (interpret that as China vs Trump) and a desire to continue retiring boom-time debt.

One way of describing the management vs shareholder dilemma (debt vs dividends) is to accept a Macquarie Bank description of mining market conditions as a “free cash-flow sweet spot” – with the inference being that sweet spots do not last for long.

Commodity price forecasts point to a contraction over the next 12 months from their recent recovery highs. Credit Suisse, another investment bank, reckons iron ore will return to $US55 this year from close to $US80 today, copper will rise to $US2.45 a pound before easing to $US2.05 in 2018, and met-coal will be back at $US130 next year.

Two commodities likely to continue trending up, according to Credit Suisse, are gold and nickel with gold rising to $US1338 an ounce from its current $US1193, while nickel is tipped to rise from its current $US4.59 a pound to $US5.25, on its way back to $US6 in 2018.

A lot can go wrong over the next 12 months, just as a lot went right over the past 12 months, but the overall trend is likely to be positive such is the cyclical nature of commodities as they recover from five bad years.

*Next week the small end of mining will be in focus, along with a look at the surprisingly high number of new projects being developed, or planned, in an attempt to capture the industry’s cash-flow sweet spot.*

***Investors should expect some changes at Hunter Hall following the departure of founder Peter Hall as the fund manager's investment team takes a fresh look at the firm's holdings.***

BY MITCHELL SNEDDON • EUREKA REPORT • 13 JANUARY 2016

# Hunter Hall becomes the hunted

It was anything but a relaxing Christmas for the team at Hunter Hall International. Through a flurry of ASX announcements one of the stranger stories unfolded, and due to the quiet holiday news cycle it also played out in News Corp and Fairfax papers.

### *Key Point*

- ***However, we have no reason to believe it won't be business as usual for the listed investment company, perhaps minus a couple of larger holdings.***

Peter Hall, charismatic Chief Investment Officer and founder of Hunter Hall, for his own reasons has resigned. Hall oversaw the management of five unlisted unit trusts and one listed investment company (LIC) totalling a combined funds under management value of approximately $1.1 billion.

The strangest twist to the story is Peter Hall selling 19.9 per cent of HHL to Washington H Soul Pattinson (SOL) for $1 per share. At the time the shares were approximately $3.10.

Soul Patt's is now potentially going to buy out the rest of Hall's stake at $1 per share as well.

Any guesses as to why Hall would sell for less than a third of the price the shares last traded at is open to speculation, and what the future holds for the listed fund manager and LIC is also speculation.

When listing in 2004 the LIC had a 25-year contract with Hunter Hall as the investment manager. This does not change. What does change is that Peter Hall will no longer be managing his component of the portfolio.

I had the chance to speak with the newly appointed interim CIO, James McDonald. McDonald has been with Hunter Hall since 2003 and has been the portfolio manager of the LIC since October 2014.

McDonald noted that Hall managed approximately 48 per cent of the LIC portfolio, of which 16 per cent was in cash. With Hall's departure the investment team will sit down and look over the 32 per cent of Hall's portion that was invested.

As when any analyst leaves a funds management company there will be stocks the team will agree on and feel comfortable to keep, while others will be shown the door. This is not a bad thing. You do not want the team continuing to hold companies they are not 100 per cent across.

In **this recent video**, I discuss the recent happenings at Hunter Hall with analyst Philip Bish in more detail.

To get a good picture of the style of McDonald compared to Hall, you might want to take a look at two of Hunter Hall's unlisted funds. **The Global Equities Trust** is managed by McDonald and the **High Conviction Equities Trust** was managed by Hall.

Hall was more bullish on gold and resources companies as well as Sirtex. Even HHL Chairman Kevin Eley was quoted as saying the rest of the investment team was more risk averse than Hall.

It is interesting to note, when Peter Hall **sat down with us in November** that he specifically made mention to the amount of shares the LIC has bought back over the years to very little effect.

He said he religiously believed paying consistent fully franked dividends was the only way to keep the share price close to the net tangible assets (NTA). Three hours after the announcement of Hall's resignation the board of HHV announced a share buyback.

Right now the LIC sits approximately at a 6 per cent discount to NTA. We have no reason to believe it won't be business as usual for the LIC, perhaps minus a couple of its larger holdings.

If Soul Patt's bid for the rest of the shares is successful it has stated it will not look to change the investment operations, people or culture of the business. Making up a third of funds under management, the LIC is a vital component of the Hunter Hall business.

That being said, the HHV shareholders may feel differently.

Investors should keep in mind any shareholder with 5 per cent or more of shares on issue is able to call an extraordinary general meeting.